

Message Text

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ACTION EUR-12

INFO OCT-01 EA-07 NEA-10 IO-11 ISO-00 AID-05 CIAE-00 EB-07

FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03

SP-02 CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15

STR-04 CEA-01 AGR-05 FEA-01 PA-01 PRS-01 L-03 H-02

DODE-00 /121 W

----- 082859

R 062321Z APR 76

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 0523

INFO AMEMBASSY BERN

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AMEMBASSY BRUSSELS

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DEPARTMENT PASS TREASURY AND FRB

E.O. 11652: N/A

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TAGS: ECON, UK

SUBJECT: FISCAL MEASURES AND INCOMES POLICY CONSIDERATIONS IN THE U.K. BUDGET

SUMMARY. THE APRIL 6 BUDGET CONTAINS AN UNPRECEDENTED LINK BETWEEN FISCAL POLICY AND INCOMES POLICY. BY CLEARLY LINKING THE EXTENT OF INCOME TAX RELIEF TO THE LEVEL OF THE NEXT PHASE OF WAGE RESTRAINT, THE CHANCELLOR HAS GAMBLERD ON A POLICY DESIGNED TO ACHIEVE YET A FURTHER HALVING OF BRITAIN'S RATE OF INFLATION BY THE END OF 1977.
END SUMMARY

1. THE FISCAL MEASURES OUTLINED BY THE CHANCELLOR COMBINED ABOUT 370 MILLION POUNDS IN INDIRECT TAX INCREASES ON ALCOHOL, TOBACCO, AND PETROL, WITH 370 MILLION POUNDS OF UNCONDITIONAL DIRECT TAX RELIEF AIMED LARGELY AT THE ELDERLY, CHILDREN AND WIDOWS WITH AN ADDITIONAL 930 MILLION POUNDS OF FURTHER TAX RELIEF CONDITIONED ON THE ACCEPTANCE OF A 3 PERCENT WAGE LIMIT BY ORGANIZED LABOR.

2. THE CHANCELLOR AGREED THAT THE SIZE OF THE CONDITIONAL TAX RELIEF WOULD DEPART FROM THE 930 MILLION FIGURE TO THE EXTENT THAT THE WAGE RESTRAINT AGREEMENT DEPARTED FROM 3 PERCENT. HE STATED THAT THE PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) WOULD RISE TO 12 BILLION POUNDS IF THE TAX RELIEF UNDER A 3 PERCENT WAGE LIMIT WERE ENACTED, A RISE OF SOME 0.8 BILLION FROM THE 11.2 BILLION POUND PSBR WHICH WOULD RESULT WITH THE 370 MILLION POUND OFFSETTING TAX PACKAGES TO BE IMPLEMENTED WHATEVER THE OUTCOME OF THE WAGE NEGOTIATIONS.

3. THE FOLLOWING PARAGRAPHS OUTLINE THE PROPOSED TAX CHANGES CONTAINED IN THE BUDGET MESSAGE.

-- TAX INCREASES

A. EXCISE TAXES

SPIRITS -- AN ADDITIONAL 32 P PER STANDARD BOTTLE (EXPECTED ADDITIONAL REVENUE 25 MILLION POUNDS)

BEER -- AN ADDITIONAL 1 P PER PINT (EXPECTED ADDITIONAL REVENUE 95 MILLION POUNDS)

WINE -- AN ADDITIONAL 6 P PER STANDARD BOTTLE

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OF TABLE WINE AND UP TO 12 P PER STANDARD BOTTLE OF FORTIFIED WINE (EXPECTED ADDITIONAL REVENUE 25 MILLION POUNDS)

CIDER -- A NEW DUTY OF 3 P PER PINT (EXPECTED ADDITIONAL REVENUE OF 10 MILLION POUNDS)

CIGARETTES -- ABOUT 3 P MORE PER PACKET OF 20 (EXPECTED ADDITIONAL REVENUE 115 MILLION POUNDS)

PETROL -. AN INCREASE OF 7.5 P PER GALLON IN
THE HYDROCARBON OIL DUTY OFFSETTING THE REDUCTION
FROM 25 TO 12.5 PERCENT IN VAT. THE NET EFFECT
IS TO INCREASE THE TAX ON GASOLINE BY 1 P PER
GALLON.

B. CHANGES IN THE VAT

A REDUCTION IN THE 25 PERCENT RATE ON LUXURY
GOODS TO 12.5 PERCENT (NET COST 175 MILLION
POUNDS). THESE CHANGES IN INDIRECT TAXATION ARE
LARGELY IN LINE WITH PRE-BUDGET EXPECTATIONS AL-
THOUGH THE HALVING OF THE LUXURY LEVEL VAT TO
12.5 PERCENT WAS MORE THAN THE 5 PERCENT THAT
MOST OBSERVERS EXPECTED AND SHOULD PROVIDE A
FILLIP TO THE DEPRESSED CONSUMER APPLIANCE SEC-
TOR. IN THIS CONNECTION THE CHANCELLOR WARNED

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STR-04 CEA-01 AGR-05 FEA-01 PA-01 PRS-01 L-03 H-02

DODE-00 /121 W

----- 083152

R 062321Z APR 76

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 0524

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DEPT PASS TREASURY

THE JAPANESE AGAINST USING THE OCCASION SHARPLY TO IN-
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CREASE EXPORTS OF COLOR TELEVISION SETS TO THE U.K.

4. THE CHANCELLOR PROPOSED A PACKAGE OF UNCONDITIONAL TAX RELIEF INCLUDING A LIBERALIZATION OF ALLOWANCES FOR TAX PAYERS OVER 65, AN INCREASE IN THE INCOME THEY MAY EARN BEFORE BECOMING SUBJECT TO TAXES, AND HIGHER ALLOWANCES FOR CHILDREN AND SINGLE WOMEN PENSIONERS UNDER 65 AND WIDOWS, THUS BRINGING THE TOTAL RELIEF FROM DIRECT TAXATION TO 370 MILLION POUNDS.

5. HOWEVER, THE KEY TO THE BUDGET LIES IN THE RELIEF PROMISED BY THE CHANCELLOR IN THE AREA OF DIRECT TAXATION. IF THE 3 PERCENT WAGE NORM WERE ACCEPTED, FURTHER TAX RELIEF WOULD BE ENACTED IT WOULD CONSIST OF INCREASING PERSONAL ALLOWANCES BY 60 POUNDS FOR SINGLE PEOPLE AND 130 POUNDS FOR MARRIED PEOPLE AND INCREASING THE THRESHOLDS FOR HIGHER MARGINAL TAX RATES BY 500 POUNDS FOR THOSE EARNING BETWEEN 5,000 AND 8,500 POUNDS. THE HIGHER THRESHOLDS MEAN THAT THE MARGINAL TAX RATE INCREASES FROM 35 TO 40 PERCENT AT 5,000 POUNDS RATHER THAN 4,500 WITH EACH SUCCEEDING THRESHOLD THROUGH 8,500 POUNDS BEING SIMILARLY RAISED.

6. THESE CONDITIONAL TAX MEASURES ARE AIMED AT PROVIDING ADDITIONAL DISPOSABLE INCOME IN RETURN FOR A LOWER WAGE NORM. THE CHANCELLOR EXPLAINED THAT THEY WERE TAILORED TO PERMIT THOSE AT THE LOWER END OF THE INCOME SCALE AND THOSE WITH LARGER FAMILIES TO ACHIEVE GREATER GAINS IN REAL INCOMES THAN WOULD BE ACHIEVED FROM A HIGHER NOMINAL

WAGE INCREASE.

7. THE CHANCELLOR TRIED TO SWEETEN THIS OFFER EVEN FURTHER BY OBSERVING THAT THE PROPOSED TAX RELIEF WOULD BEGIN AS SOON AS THE 3 PERCENT WAGE NORM WAS AGREED. (HE ASKED THE TUC TO GIVE ITS REACTION BY EARLY JUNE.) HOWEVER, ANY WAGE INCREASES DERIVING FROM SOME OTHER HIGHER NORM THAT WOULD PRECLUDE TAX RELIEF WOULD NOT BE RECEIVED UNTIL PRESENT WAGE SETTLEMENTS WERE RENEGOTIATED MAINLY DURING THE FIRST HALF OF 1977.

8. IN THE ABSENCE OF AGREEMENT ON THE 3 PERCENT NORM, LIMITED OFFICIAL USE

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THIS BUDGET CAN BE DESCRIBED AS NEUTRAL IN TERMS OF OVERALL DEMAND IF NOT SLIGHTLY DEFLATIONARY. THE ESTIMATE OF PUBLIC SECTOR BORROWING REQUIREMENT OF 11.2 BILLION POUNDS IMPLIES A DECLINE IN REAL TERMS IN OVERALL PUBLIC SECTOR CLAIMS OF BETWEEN 1 AND 2 PERCENT OF GDP ON RESOURCES GIVEN THE CHANCELLOR'S ESTIMATE OF A GROWTH IN OUTPUT OF 3.50 PERCENT OVER THE NEXT 12 MONTHS.

9. THE WIDENING OF THE PSBR AND THE MILD REFLATION RESULTING FROM THE TAX CONCESSIONS COMING IN THE WAKE OF A 3 PERCENT PAY NORM IS MANAGABLE, ESPECIALLY IF THERE IS A REAL PROBABILITY THAT INFLATION CAN BE REDUCED TO 5 TO 7 PERCENT BY THE END OF 1977.

10. THE BUDGET MESSAGE PERMITS A COMPARISON OF THE REVENUE ESTIMATES WITH PROPOSED PUBLIC EXPENDITURE. ITS MINOR ADDITIONS TO THE EXPENDITURE PROGRAM IN THE PUBLIC EXPENDITURE WHITE PAPER ANNOUNCED IN FEBRUARY (SEE PARAGRAPH 11 OF WHITE PAPER) SUGGEST THAT OVERALL SPENDING WILL BE ABOUT 600 MILLION POUNDS (1.3 PERCENT) HIGHER THAN IN THE PREVIOUS FISCAL YEAR. THE REVENUE ESTIMATES BASED ON THE CHANCELLOR'S ASSUMPTIONS OF 3.5 PERCENT REAL GROWTH, 10-12 PERCENT INFLATION AND THE 370 MILLION POUND PACKAGE OF TAX INCREASES AND OFFSETTING TAX RELIEF MAKE A ROUGHLY UNCHANGED PUBLIC SECTOR BORROWING REQUIREMENT IN ABSOLUTE TERMS A REASONABLE EXPECTATION. ESTIMATES OF FISCAL DRAG DEVELOPED IN A STUDY BY TWO ECONOMISTS AT LLOYDS BANK INDICATE THAT THE FISCAL DRAG PROVIDED BY INFLATION AND GROWTH OF THE ORDER OF MAGNITUDE EXPECTED BY MR. HEALEY WOULD GENERATE ABOUT 700 MILLION POUNDS OF ADDITIONAL TAX REVENUES WHICH IS CONSISTENT WITH THE INCREASES IN EXPENDITURE ANTICIPATED IN THE 1976/77 FISCAL YEAR.

11. IN KEEPING WITH THE GOVERNMENT'S PRIORITY ON IMPROVING THE INVESTMENT CLIMATE, THE CHANCELLOR ANNOUNCED

A SERIES OF MEASURES DESIGNED TO REMOVE MUCH OF THE UNCERTAINTY THAT HAS BEEN A FACTOR IN HOLDING UP NEW INVESTMENT. THESE MEASURES INCLUDE:

-- A FURTHER TWO YEARS OF TAX RELIEF ON INVENTORY PROFITS WITH A LIBERALIZATION OF THE BASIS ON LIMITED OFFICIAL USE

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WHICH THE BASE IS CALCULATED

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DODE-00 /121 W

----- 083015

R 062321Z APR 76

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DEPT PASS TREASU

-- A CONTINUATION OF THE SYSTEM OF 100 PERCENT DE-
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PRECIATION ALLOWABLE IN THE FIRST YEAR OF AN IN-
VESTMENT

-- AN ABOLITION OF THE 2 PERCENT STAMP TAX ON
SALES OF CORPORATE BONDS.

12. OFFSETTING THESE IMPROVEMENTS WERE NEW POWERS TO
DEAL WITH TAX EVASION AND TAXATION OF HITHERTO UNTAXED
FRINGE BENEFITS SUCH AS COMPANY CARS AND LOW INTEREST
LOANS. THE CHANCELLOR ANNOUNCED SOME MODIFICATIONS
AND EASING OF THE CAPITAL TRANSFER TAX AS IT AFFECTS
SMALL BUSINESS AND REDUCED THE BURDEN OF CORPORATION IN-
COME TAXES ON SMALL BUSINESS.

13. IN A FURTHER ATTEMPT TO STIMULATE EMPLOYMENT THROUGH
MICROECONOMIC MEASURES ALONG THE LINES OF THE THREE PACK-
AGES ANNOUNCED IN SEPTEMBER 1975 AND FEBRUARY 1976, THE
CHANCELLOR ANNOUNCED A FURTHER LIBERALIZATION OF THE TEM-
PORARY EMPLOYMENT SUBSIDY FROM 10 TO 20 POUNDS PER WEEK
PER EMPLOYEE NOT LAID OFF AND EXTENDED THIS PROGRAM
THROUGH THE END OF 1977. IN ADDITION, A FURTHER 40 MIL-
LION POUNDS WOULD BE MADE AVAILABLE FOR INDUSTRIAL IN-
VESTMENT SCHEMES.

14. THE ELEMENTS OF THE BUDGET CONCERNING INVESTMENT
ARE NOTEWORTHY FOR THE CARE EXERCIZED BY THE CHANCELLOR
IN BALANCING THE COMPETING DEMANDS OF BUSINESS AND LABOR.
HE WENT FAR IN MEETING THE REPEATED CALLS FROM CBI TO
CREATE A STABLE INVESTMENT CLIMATE BY PROMISING NO
CHANGE OVER THE NEXT 2 YEARS IN GOVERNMENT POLICY ON THE
TAXATION OF INVENTORY PROFITS THIS WAS BALANCED BY HIS
AGREEMENT TO STUDY A TUC PROPOSAL FOR A COUNTERCYCLICAL
INVESTMENT SCHEME SIMILAR TO THE ONE EXISTING IN SWEDEN.
HE RESPONDED TO LABOR PRESSURES TO DO SOMETHING ABOUT
UNTAXED FRINGE BENEFITS AND TO IMPROVE THE SIZE OF PEN-

SIONS WHILE AT THE SAME TIME ACCEDING TO BUSINESS DEMANDS TO REDUCE THE RATE OF VAT ON CONSUMER DURABLES. THESE TRADE-OFFS ARE NO DOUBT DESIGNED TO WIN BROADLY-BASED NATIONAL SUPPORT FOR THE ENTIRE PACKAGE MR. HEALEY HAS GAMBLER THAT THERE IS ENOUGH IN THE OVERALL PACKAGE FOR EACH GROUP THAT IT WILL BE PREPARED TO ACCEPT SOMETHING LESS THAN COMPLETE SATISFACTION IN THE GREATER LIMITED OFFICIAL USE

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INTEREST OF THE COUNTRY AS A WHOLE IT WILL BE SEVERAL MONTHS BEFORE EITHER MR. HEALEY OR ANYONE ELSE KNOWS WHETHER HE HAS WON.

ARMSTRONG

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: POLICIES, ECONOMIC PROGRAMS, TAXES
Control Number: n/a
Copy: SINGLE
Draft Date: 06 APR 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: GolinoFR
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976LONDON05317
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D760130-0207
From: LONDON
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1976/newtext/t19760493/aaaadbts.tel
Line Count: 403
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 8
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: GolinoFR
Review Comment: n/a
Review Content Flags:
Review Date: 30 MAR 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <30 MAR 2004 by ShawDG>; APPROVED <31 MAR 2004 by GolinoFR>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: FISCAL MEASURES AND INCOMES POLICY CONSIDERATIONS IN THE U.K. BUDGET
TAGS: ECON, UK
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006